DOCKET FILE COPY ORIGINAL

BEFORE THE

Federal Communications Commission

WASHINGTON, D.C. 20554

RECEIVED

AUG 25 1993

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992 Rate Regulation	))))))))	MM Docket No. 93-215

To: The Commission

COMMENTS OF MUZAK LIMITED PARTNERSHIP

Muzak Limited Partnership ("Muzak"), by its attorneys, hereby files it comments in response to the Notice of Proposed Rule Making, released July 16, 1993, in the above-captioned proceeding (the "Notice"). In these Comments, Muzak supports the Commission's recognition of the need to enact regulations protecting cable TV subscribers from excessive rates that could result from improper cross-subsidization, misallocation of joint and common costs, and improper intra-corporate transfers, by cable TV operators.

I. The Provision of Audio Services by Cable TV Operators.

Muzak produces and delivers music services to approximately 200,000 subscribers, primarily businesses, throughout the United States. The provision of music services to businesses, alone or in conjunction with other audio information, video and data transmission services[1], is currently growing at a substantial rate, and competition to provide such services will continue to grow along with the size of that market.

No. of Copies rec'd 0+4
List A B C D E

[1] While the provision of music services is Muzak's "core" business, it also offers one-way transmission of other business audio programming, such as in-store advertising, one-way data transmission, and private video conferencing services.

While the primary focus of cable TV operators is currently the provision of video services, many cable operators also presently provide audio programming services. Such services include programming (e.g., "Digital Music Express" and "Digital Cable Radio"[2]) offered to residential subscribers, as well as programming offered to businesses and designed to compete with programming offered by Muzak. Unfortunately, Muzak has often seen, in markets throughout the country, cable operators offer audio services to businesses at rates so dramatically low as to suggest that these services were being offered at or below cost. This predatory tactic is designed to undercut services offered by, and eliminate competition from, non-cable system providers.

Regardless of the impact on competition, however, it is obvious that cable operators must recover the costs of unregulated services from somewhere, and the obvious source is from subscribers to regulated video services. Costs of unregulated services are allocated to regulated services, and as a result, residential subscribers to regulated cable video services end up paying for the costs of unregulated business audio services. This cross-subsidization will likely continue and expand as cable operators expand their provision of non-traditional services and compete for market share against existing providers of those services. This result is clearly contrary to the goal of preventing unreasonable rates to consumers, which was the underlying purpose of the Cable

[2] Both Digital Cable Radio and International Cablecasting Technologies, Digital Music Express' corporate parent, are owned in part by major cable television MSOs.

Television Consumer Protection and Competition Act of 1992 (the "1992 Cable Act" or the "Act").[3] Accordingly, it is proper and necessary that, in crafting cost of service ("COS") regulations, the Commission consider specific regulations that limit or prevent abusive cross-subsidization.

II. The Commission Must Enact Regulations Preventing Cable Operators From Improperly Shifting the Costs of Unregulated Services Onto Subscribers of Regulated Services.

Section 3 of the Act amended Section 623 of the Communications Act to require the Commission to enact regulations ensuring that the rates paid by consumers for "basic services" and "cable programming services" are reasonable. In its initial Report and Order in this proceeding, the Commission adopted an approach that primarily relies on benchmarks and price caps to ensure that subscribers of regulated cable services are charged reasonable rates.[4] That initial Report and Order also provided, however, that cable operators whose rates were above the appropriate benchmark could attempt to justify such rates through a cost of service showing.

---

[3] See Sections 2(a)(1), 2(a)(2), 2(b)(4) and 2(b)(5) of the Act; See also House Committee on Energy and Commerce, H.R. Rep. No. 102-628, 102d Cong., 2d Sess. at 26 (hereinafter, the "House Report"):

> H.R. 4850 is designed to address the principal concerns about the performance of the cable industry and the development of the market for video programming since passage of the [1984] Cable Act. This legislation will protect consumers by preventing unreasonable rates ....

[4] Report and Order in MM Docket No. 92-266, FCC 93-177, 58 Fed. Reg. 29736 (May 21, 1993).

In enacting COS regulations in this proceeding, it is important for the Commission to recognize that preventing improper cost-shifting is not only a good policy, it is one that is mandated by Congress in the Act. For example, in establishing the structure of the regulations the Commission must enact to meet the goal of ensuring reasonable basic rates, Section 623(b)(2)(C)(iii) provides that the Commission shall take into account:

> only such portion of the joint and common costs (if any) of obtaining, transmitting, and otherwise providing such signals as is determined, in accordance with regulations prescribed by the Commission, to be reasonably and properly allocable to the basic service tier, and changes in such costs;

In enacting that provision of the Act, Congress clearly contemplated the danger of improper cost-shifting, and in fact stated that costs allocated to rates for basic services "must not be permitted to serve as the base that allows for marginal pricing of unregulated services."[5]

The Commission itself has previously recognized that improper shifting of costs from unregulated services leads to unreasonable rates for subscribers of regulated services. See, e.g., Telephone Company-Cable Television Cross Ownership Rules, Further Notice of Inquiry, 3 FCC Rcd 5849, 5859 (1988), wherein the Commission stated that:

> ... we have established in the Joint Cost proceeding a system of accounting designed to

[5] See H.R. Rep. No. 862, 102d Cong., 2d Sess., at 63 (1992)(hereinafter the "Conference Report"). See also the House Report at 83 ("The regulated tier cannot be permitted to serve as a base that allows for marginal pricing of unregulated services.").

> prevent carriers from imposing costs and risks of nonregulated activities on ratepayers for regulated services. This accounting system protects ratepayers from unjust and unreasonable interstate rates that could otherwise result from cross-subsidization, misallocation of joint and common costs and improper intracorporate transfer pricing.

Accordingly, the Commission has precedent for, and a Congressional mandate to,[6] enact COS regulations that aim to limit cross-subsidization, misallocation of joint and common costs, and improper transactions between cable operators and non-regulated affiliates.

III. Proposed Regulations

The Notice seeks comments, inter alia, on three different areas of proposed regulations that could limit the ability of an operator to improperly shift costs onto residential cable subscribers. These proposals are discussed below.

A. Cost Accounting and Cost Allocation Requirements

In Appendix A of the Notice, the Commission proposed certain cost accounting requirements to supplement its more general requirement that cable operators maintain their accounts in accordance with Generally Accepted Accounting Principals. In addition, the Notice cites Section 76.924(g), which requires that

---

[6] Based on the language of Section 623 of the Communications Act, and the legislative history cited above, Congress clearly mandated regulations that would prevent improper cost-shifting. Thus while, as the Commission recognizes in note 16 of the Notice, Congress also indicated a preference that cable rate regulation not replicate Title II common carrier rate regulation, the COS regulatory structure proposed by the Commission is consistent with Congressional requirements, especially since the COS mechanism supplements the benchmark mechanism, and would be voluntarily chosen by a cable operator.

operators exclude unrelated expenses and revenues from cost categories for regulated cable services, when allocating costs. Notice at para. 59. The Notice seeks comments as to whether these proposals are sufficient.

It should be noted, as a guiding principal, that cross-subsidization and other similarly improper practices are difficult to discover or prevent without the presence of detailed accounting and allocation requirements which allow an auditor to retrace the flow of funds. One example of such a set of requirements is the Commission's Uniform System of Accounts ("USOA") as set forth in Part 32 of the Commission's Rules. While Muzak does not advocate that cable accounting and allocation requirements be as detailed as USOA, USOA should be taken as a model for cable rules. At very least, it is clear that Section 76.924(g) alone, as it stands now, will not suffice to prevent improper cost allocations.

While Appendix A proposes certain cost accounting categories for use in a COS showing, these categories may not be sufficient. Specifically, the Commission must either establish a category for non-regulated cable activities such as audio services or clarify that costs associated with such non-regulated cable services are to be placed in the "Other Cable Programming Services Activities" or "Other Cable Activities" categories. Furthermore, it is imperative that the accounting rules require operators to account for all of the operator's costs for both regulated and non-regulated activities, so that if necessary, an auditor can deduce whether cost allocations were made properly.

B. Affiliate Transactions

In paragraph 67 of the Notice, the Commission recognizes that transactions between a cable operator and an affiliate of that operator can be priced at a level that results in the regulated enterprise paying an undue portion of the costs of the unregulated affiliate. The Commission recognizes that this is improper cross-subsidization, and states that it will adopt rules to prevent such transactions. The Notice also seeks comments on applying such prohibitions to transactions between regulated and non-regulated portions of the same cable company, i.e., intra-company transfers. Id. at note 67.

Muzak fully supports the enactment of affiliate and intra-corporate transaction rules. The Commission's experience with common carriers has demonstrated that such rules are necessary to prevent improper cross-subsidization. Muzak believes that the complex financial transactions involved in cable operations, which should increase as cable operators increasingly provide non-video programming and voice/data carriage services, require rules limiting improper transactions. The Commission's common carrier affiliate transaction rule, 47 C.F.R. Section 32.27, provides an appropriate model for use with cable operators.

IV. Conclusion

In light of the importance placed by Congress on protecting consumers from unreasonable rates for cable service, the Commission's COS regulations must address and prevent improper shifting of costs from unregulated audio services to regulated video services. The proposals presented in the Notice, as discussed herein, should be at least a first step towards preventing such practices and establishing reasonable rates for subscribers of regulated cable services.

Respectfully submitted,

MUZAK LIMITED PARTNERSHIP

By: Paul J. Feldman

Edward W. Hummers, Jr.
Paul J. Feldman

Its Attorneys

Fletcher, Heald & Hildreth
11th Floor
1300 North 17th Street
Rosslyn, VA 22209
(703) 812-0400

August 25, 1993